1935

Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE decision of the Supreme Court in the Schechter poultry code case, which invalidates the essential provisions of the National Industrial Recovery Act, is of course the most important development in the business situation during the past month. The decision holds that code-making, as provided for by the Act, is a legislative procedure which the Congress had no power to delegate to the Executive in the sweeping manner of the Act; also that the authority of Congress to regulate commerce between the States has been exceeded in the regulation of hours, wages and other practices of intrastate business, where their effect upon interstate commerce is merely indirect. The decision thus outlaws the codes, and deprives them of further authority, although business men may voluntarily adhere to them, provided they do not enter agreements violating the anti-trust laws.

That some time may be required for the full effects of this momentous decision to show themselves in business is to be expected. The possibility of confusion lies in the withdrawal of Government enforcement from the code provisions fixing prices, wages and hours. A quick breakdown of these provisions, and a spread of price-cutting competition, would naturally unsettle business for a time, make necessary some difficult adjustments, and check buying until the markets settled down. With more than 650 industries under the codes, it is natural to expect that in some cases the immediate effects of the decision will be of that character.

However, the elements of strength in the business situation, and the attitude of business men, together seem to bar the possibility of a general or disorderly breakdown. In industries where the effect upon price-fixing provisions is the important consideration it had already been recognized that the trend had turned against price-fixing, both in law and in practice. Business had been on notice for some time that in the extension of the Act after June 16 these provisions would be largely eliminated, and the trades affected have already been taking that into account. Also, enforcement of price provisions has become less effective as time has gone on. In some lines buying has been deferred in recent weeks because of this uncertainty, and may be for some time longer, but the result is that demand is accumulating, and of course if prices are reduced the long run effect will be to increase the volume of goods moving.

Attitude of Employers

The new possibility presented by the Supreme Court decision is that price competition may be conducted by reducing wages and increasing hours, if industry is of that mind; but there is little reason to think that this will generally be the case. American business men have no wish to be niggardly with labor; as a class they believe in the doctrine of good wages, and the attitude of responsible employers throughout the depression has been in accord with that belief. After the decline began they withheld wage cuts in most cases until 1931, hoping that improvement would make them unnecessary. They have readily accepted the wage increases established under the N.R.A., even though it became evident that the advances were being put into effect more rapidly than the productivity of labor could justify, and that the resulting price increases were handicapping trade.

Since these wage increases were established more than a year and a half has elapsed, and in that period technical improvements increasing labor productivity have been made, business has improved, and the manufacturing industries have climbed from the red into the black. The ability to support the N.R.A. scales has increased accordingly. Also, business is better organized to preserve higher standards of competition than ever before. Business men have had a new experience in cooperation, and unquestionably the great majority desire to preserve its benefits.

The public announcements made by many corporations and trade associations since the

decision, stating their intention to abide by code standards, show that the foregoing correctly describes the employers' attitude. These announcements give responsible assurances against an epidemic of wage cutting as long as business conditions will permit the industries to pay present scales; and fortunately there are many features in the business situation, as described in the following pages of this Letter, which are encouraging.

Benefits of the Decision

The foregoing comments, however, should not obscure the fact that the decision will be beneficial in the long run precisely because it abandons arbitrary wage and price fixing. An economic situation supported by arbitrary regulations is almost certain to be unstable, and to inspire endless worry and distrust; and the decision removes an obstacle to the natural efforts of business to find a more stable equilibrium, in which genuine confidence can be felt.

It should be recognized that there are some arbitrarily maintained wage levels, notably in the railways and the building industry, and some pegged prices, which are obstacles to recovery. Wages and prices should both be free to respond to economic pressure, whether it is operating to lower or raise them, for when they are arbitrarily fixed the self-balancing character of the economic system is impaired. The conduct of trade, which is the exchange of goods and services, depends upon the maintenance of fair and practicable terms of exchange, and such terms can be had only when costs and prices are free to alter as conditions alter. Hence the system does not work well when there are rigid and inflexible elements in it and its freedom of adjustment is interfered with.

Conversely, restoration of the freedom of movement in prices and wages, through the operation of fair competition and fair bargaining, increases the flexibility of the system and therefore its ability to find a sound equilibrium. Only through flexibility of costs can the industries make prices to fit the markets, move their goods, and give employment; and only through flexibility of prices as enforced by fair competition can the maximum of benefits which the economic system can produce be distributed.

It is true that the overhead control was established for the purpose of curing an existing disorder, and the trial was accepted by the American people on that ground. However, it could succeed only as it facilitated natural adjustments, and unfortunately its effects have been too often to the contrary. Moreover, a lesson has been given as to the impracticability of enforcing overhead control upon the Constitutional system of free enterprise which has been unanimously and so emphatically upheld by the Supreme Court, and under which the overwhelming majority of the American people undoubtedly prefer to live.

Another important aspect of the decision is that it will remove the limitations on the installation of new productive capacity, which were included in some of the codes. These provisions embodied in the law the fallacious principle that those already in a given field were entitled to stay in it against all comers, irrespective of their abilities, a principle utterly opposed to progress and deadening to enterprise. The effect has been to penalize the capital goods industries by arbitrarily limiting their markets, and since these industries have long constituted the chief area of depression the decision in that respect is a very encouraging one.

Seasonal Recession Begins

The first effect on business of the decision has been to unsettle some raw material prices, and to slow up buying of merchandise for forward needs. However, the movement of Summer goods, which was slow early in the month due to cold and wet weather, improved during the last week on more seasonable temperatures.

As a rule May brings an irregular slackening of industrial activity, following the Spring peak, and this slackening has appeared to a moderate degree in the automobile and other industries which have been the leaders in Spring business. Since curtailment has continued in various textile, apparel and other light lines, industrial operations as a whole have fallen below the April level.

In contrast with this trend, both commodity and security markets, prior to the unsettlement caused by the decision, turned in good performances. The rise in industrial stock prices in the middle of the month carried them to the highest level, in the Dow-Jones averages, since September, 1931.

One explanation of the improvement in stock prices is supplied by the easy money conditions. The opinion that easy money may soon begin to have an effect on the business situation seems to be spreading. To be sure, commercial bank loans are not rising, seasonal influences are against expansion for some time to come, and the amount of new money going into use through the capital markets is negligible. But the large refunding operations already carried out and in prospect, which reduce yields to lenders, increase the incentive for investors to reach down into the lower-rated bonds and stocks. It is plain that there is more willingness than heretofore to accept business risks in the employment of funds, for the sake of a better return. This is an important gain in investment psychology. Also, corporations are able to spend more freely,

with earnings better, and fears of refunding difficulties relieved. All this marks at least a first step toward a greater employment of capital in productive uses, although too high hopes of new capital issues would be unwarranted, in view of the scarcity of borrowers of good standing and earning capacity, the uncertainty as to profits, and the obvious tendency to limit loans to established and profitable enterprises.

It is improbable that the tendency of investment funds to spread into equity ownership has represented any conscious effort to find protection against further depreciation of the dollar. The improvement in commodity prices was not of that character, since it centered in industrial raw materials rather than in speculative favorites. The movement of capital on international account during the period has been toward the dollar. Most important of all, the developments in the monetary situation during the month have been of a nature to diminish fears of printing press inflation. President Roosevelt's strong veto message on the bonus bill, and the action of the Senate sustaining him, seem to have disposed for this session of proposals to print greenbacks. Also, Secretary Morgenthau's speech early in the month was evidently intended to open the problems of international currency stabilization to discussion, although the difficulty of finding appropriate terms and accommodating national policies to the requirements of international stability still seems insurmountable.

Record of the First Four Months

The recession in industrial operations now under way actually began three or four months ago, as is shown by the following table giving the Federal Reserve Board's indexes of industrial production for each month since the beginning of the year; but through April the decline was slight. The table gives both the unadjusted index, which measures the actual volume of production, and the adjusted figure, which makes allowance for the normal seasonal trend:

1923-25=100

	Unadjusted		Adjusted for Seasonal	
	1935	1934	1935	1934
January	88	77	90	78
February	91	83	89	81
March	90	86	88	85
April	89	88	86	86

It will be seen that, while there was a slight recession after February instead of the usual seasonal advance, causing a decline in the adjusted index, the actual volume of production remained remarkably constant during the four months, and on the average was 7 per cent above a year ago.

After four months of improvement, a brief review may be in order. Unquestionably the extent of the upturn affords reason for encouragement. The peak was higher than the peak last Spring, and the period as a whole was better, except for the boom months in the Summer of 1933, than any period of equal length since the first half of 1930. The 1933 boom was of speculative character, political and economic factors combining to induce forward buying, but this Spring the situation has been more normal. There has been some "rushing the season" in certain lines, fear of labor troubles being a cause, but for the most part the increase in production has been in line with sales for consumption.

Government expenditures have been less of a factor in purchasing power than they were last year. For the four months the total expenditures of the Treasury were $2,315,000,000, compared with $3,201,000,000 last year, and the deficit, exclusive of sinking fund, was $870,000,000 compared with $1,858,000,000. This also marks the upturn as of better quality than last year.

Gains More Widely Distributed

The chief reason, however, for the good impression made by the business figures is that the upturn has extended more broadly into the durable goods industries. The automobile improvement is the outstanding example, with sales of passenger cars in the first quarter up 73 per cent from last year, truck sales up 50 per cent, and April production the highest of any month since August, 1929. This increase has been shared by a wide variety of other lines. Farm implement business has had almost as great a gain, with producers pressed to keep up with orders, and current estimates are that the year's business will be 50 per cent above last year.

In the household equipment field impressive gains have been made. Refrigerator sales in the first quarter were 53 per cent above last year, and while the April comparison showed a small drop the four months were still 25 per cent ahead. Washing machine sales have made a fair increase, and companies making other electrical appliances reported gains of 20 to 50 per cent for the first quarter.

Likewise the manufacturing industries have been spending more on purchases of machinery for replacement and modernization. Machine tool orders in the first quarter were 25 per cent above last year. They made a still greater gain in April and according to preliminary reports in May also, and these increases were against the usual seasonal trend. Increased sales of motors and other light equipment have played a part in the betterment in electrical equipment business. Improvement in Diesel engines and their application to new fields has brought extraordinary increases in production and sales. According to authoritative esti-

mates, sales of Diesel engines in 1934, measured in horsepower, totaled 758,000, while this year they are expected to reach 2,000,000. Three years ago they were negligible.

It is recognized by all analysts of the situation that no business upturn can go far or last long except as it spreads into industries of the type mentioned. It is in them that unsatisfied wants are greatest. People who have given up their automobiles during the depression naturally want them back and the evidence is that they are buying them back as rapidly as they can. The market for electrical equipment of all kinds, farm implements, and the variety of new products put forward by industry during the past five years, is far short of saturation, and the need of the industries for new cost-reducing tools and machines is endless. The American Machinist has completed a survey of the metal machinery in place in the industries, and finds that 65 per cent of it is more than ten years old, and therefore obsolete, in view of the advances in design during that time. Modern equipment is capable of 25 to 30 per cent greater output than similar machines built a decade ago, according to machine tool builders.

All this is an answer to the plea that there is less work to be done, and that the depression is of technological origin, for the truth is that it is only necessary to get people back to doing all the work that needs to be done to achieve full recovery. Before that comes, the improvement must extend not only to consumers' durable goods and lighter capital equipment of the type mentioned, but also to heavy construction and heavy equipment, such as the railways and utilities use. The worst unemployment is now in the railways and rail equipment, construction and similar lines.

Improvement in Home Building

Another field into which the improvement has extended is residential construction. Residential building contracts during the first four months, as reported by the F. W. Dodge Corporation for thirty-seven Eastern states, totaled $113,515,000, compared with $80,510,000 in the same period last year, and $58,920,000 in 1933, the low point. The first half of May showed the largest gain thus far, and the figures are the highest in over three years. Of the four months' figures, $20,000,000 represented alterations and improvements, and about $93,000,000 new construction, which is nearly half again as large as last year.

By comparison with pre-depression totals these are low figures, but the improvement is heartening. There is also evidence in the sales of lumber, plumbing supplies, paints and varnishes, and similar materials, that an equally good increase has occurred in improvement work not included in the contract figures. The lumber industry has made substantial gains. Shipments of soft woods in the first four months were 22 per cent over last year, and orders in April were 25 per cent larger. Stocks on hand are smaller, relative to production, than in several years.

The National Association of Real Estate Boards reports a rising trend in rents and decline in vacancies in a majority of cities, and an actual shortage of single family dwellings in many, also more money available for new home building, at low valuations, but at lower interest rates. It has been the view of real estate analysts that the supposed housing surplus during the depression was more apparent than real, since it resulted from doubling up of families and deferment of marriages rather than excess construction. Moreover, the space available has probably diminished, for it is believed that new residence construction since 1931 has fallen short of the combined total of fire losses and demolitions. Meanwhile there has been the population increase to be housed.

The obstacle to a more rapid improvement in building is the level of costs, which keeps the price of newly built houses at a disparity with the market prices of existing houses and with rents—in short, out of line with the incomes of those who, if they could, would build or buy.

The Present Situation

This review has put the emphasis on the favorable aspects of the 1935 upturn, which is undoubtedly where it belongs, despite the present downward trend and all the uncertainties in the situation. It is upon this natural improvement that business must count to moderate the disturbance which otherwise might grow out of the N.R.A. decision.

It is possible that the textile industries, if they can escape disturbance due to liquidation of the N.R.A., may supply the best resistance to the Summer decline. They have been lagging since Winter, and may naturally hold their ground while the more favored industries are receding, and also give the earliest start to Fall improvement. The drop in cotton mill operations has flattened out during May, and just prior to the N.R.A. decision the mills were selling more than their production. Rayon business also has improved.

Woolen business has been good, and with raw wool advancing the men's wear mills have withdrawn lines for repricing at higher levels. The rise in raw wool is in part due to the heavy consumption, and in part to the proposal embodied in the amendments to the Agricultural Adjustment Act now before Congress, whereby the "parity price" of wool would be based on the post-war (1919-29) instead of the pre-war average, and compulsory marketing agreements would be authorized. The effect would be to set the price objective

33 per cent above the present price. The wool manufacturing industry is preparing itself for a drop in consumption or a shift to cheaper fabrics if such a rise should be made effective, and if that develops the wool growers may share some of the experiences of the cotton farmers who have lost their markets. However, the legislative future of the amendments has been thrown into uncertainty by the N.R.A. decision.

Automobile production declined sharply upon the strike which tied up Chevrolet assemblies, and has recovered thereafter to a level not far below the previous peak. Ford and several other manufacturers have curtailed somewhat, indicating that the seasonal peak in output is past, and sales reports also are spotted. Steel mill operations have eased slightly, but show a satisfactory resistance to the seasonal recession, since consumers are carrying light stocks and buying for current needs. However, the trend must be considered downward, in line with automobile operations and other seasonal influences.

Retail sales have been affected chiefly by the weather. Department store sales in New York City for the first half of the month were 2 per cent under last year, but over the country gains have been more common. Crop prospects continue mixed, but the greatest gain in purchasing power is still to be found among the farming population.

Undoubtedly the legislative situation is the chief source of uncertainty in business. Fears that the Wagner Bill, which was on the way to passage, would lead to widespread labor troubles have been a damper on confidence. However, the legislative program itself has been thrown into confusion by the sweeping N.R.A. decision, and the fate of some of the proposed measures undoubtedly will be affected by it.

Money and Banking

The overshadowing development of a monetary character during the past month has been the rapidly growing crisis over the French franc. Ever since the devaluation of the Belgian currency at the end of March the feeling has been growing that the remaining gold bloc countries were in for a severe test of their determination and ability to maintain the parities of their currencies. Following the Belgian devaluation, pressure first centered on the Dutch guilder, resulting in a loss of about one-fifth of the gold holdings of the Bank of Netherlands. Owing, however, to the adoption of protective measures, including advances in the bank rate from 2½ to 4½ per cent, the attack was warded off for the time being at least, and on May 15 the bank rate was lowered to 4 per cent, accompanying some slight recovery in the bank's gold holdings. At the close of the month the rate was raised to 5 per cent, and the guilder was quoted below the gold export point, though not by a margin large enough to invite heavy gold shipments.

While Holland has been struggling with its currency situation, Switzerland has been contending with similar problems. From the end of March to date the Swiss National Bank has lost over $165,000,000 of gold, on account of withdrawals induced by the general state of alarm over currencies and apprehension as to the outcome of a popular referendum on June 2nd proposing amendments to the Federal Constitution which are generally considered to endanger maintenance of the present value of the Swiss franc. With the tourist trade in Switzerland hit by the high value of the currency the advocates of devaluation in that country are not without strong backing. On May 3rd the Swiss Bank rate was raised from 2 to 2½ per cent.

As the major gold bloc countries have continued to contend with devaluationist sentiment, a new addition to the already long list of devalued currencies was made during the month when the Free City of Danzig on May 2nd announced a 42.37 per cent cut in the value of the gulden.

The Situation in France

Thanks to the enormous gold holdings of the Bank of France, the position of the French franc has generally been regarded as more secure than that of other countries in the gold bloc, with the result that speculative pressure until recently has tended to center on Holland and Switzerland. Beginning about the middle of May, however, the French situation grew rapidly more acute as alarm commenced to be felt over the prospective budget deficit. Basically, the difficulty in France has been similar in many respects to that which prevailed in the United States before the devaluation of the dollar. It has been impossible to reduce internal prices and costs in line with the reductions accomplished abroad through devaluation. Trade, in consequence, has been depressed and it has been impossible to collect sufficient revenues to balance expenditures.

In May, as the Treasury began to experience increasing difficulty in raising required funds in the market, the nervousness of the public increased, leading to heavy demands upon the Bank of France for gold for hoarding and for export. According to a statement by Finance Minister Germain-Martin on May 28, the Bank's loss of gold from the 17th to the 24th alone amounted to over 3,166,000,000 francs ($210,000,000), notwithstanding the action by the Bank in raising its discount rate from 2½ to 6 per cent. From the 24th to the 28th further losses are estimated at approximately 2,000,000,000 francs.

In an effort to meet the situation and save the franc, Premier Flandin on May 28 asked Parliament for wide powers tantamount to a financial dictatorship. These were denied by the Parliament, leading to the resignation of the Government on the 30th. Thus, as we go to press the fate of the franc hangs in the balance. Should the political crisis be overcome, and the Government be determined to protect the franc, it has large resources for doing so. On the latest statement date, May 24th, the Bank of France reported gold holdings of 76,595,000,000 francs, equivalent to $5,078,000,000 or 78.32 per cent of total sight liabilities.

U. S. Gold Holdings Increase

The past month has repeated the old story of bank reserves in the United States rising continuously higher and higher to new record levels. During this period the rise was due partly to disbursements of Government funds from the Treasury and Reserve Banks, and partly to the further inflow of gold induced by the flight of capital from European gold bloc countries. During the latter part of April and early May rallying tendencies in the gold currencies suspended temporarily the contracting of gold for shipment to the United States. Following May 8, however, exchange rates again declined, resulting in purchases through the 28th amounting to $130,000,000, most of which were made in France. Counting $147,000,000 bought between April 5 and April 25, the total purchases over two months' time have aggregated over $277,000,000. This is in addition to $285,000,000 actually imported during the first quarter of the year and $1,416,000,000 imported between the time of the devaluation of the dollar on January 31, 1934, and the end of March, 1935.

With gold purchases through the 28th aggregating $130,000,000, actual receipts of gold at United States ports for the period were $93,000,000. These, together with a small quantity of domestic gold purchases, carried the total monetary stocks of the country to a new high total of $8,762,000,000.

Bank Reserves at New High

With gold flowing into the country in an unabated stream, and Treasury payments also adding funds to the market, the volume of member bank reserves increased by $100,000,000 during the three weeks ended May 22 to a new high record of $4,821,000,000. Inasmuch as required reserves on that date amounted to only $2,459,000,000, it is clear that the member banks have reserves twice as large as they need for carrying the existing volume of deposits. Were it possible for the banks to employ these excess reserves in loans and investments the total volume of member bank credit would be in the neighborhood of $50,000,000,000, or 50 per cent above the maximum reached during the 1928-29 boom. And every week bank reserves are being built up still further by the continued inflow of gold.

There has been no material change in the prevailing low volume of commercial loans outstanding or in the nominal rates of interest available from surplus funds placed in stock exchange loans, commercial paper and bankers' acceptances.

The Bond Market

Excess bank reserves and low rates have continued to furnish strong support to the bond market and to push prices of numerous Government and other prime grade bonds into new high ground. A number of additional new issues were sold during the month for the purpose of refunding other issues bearing higher coupons that will mature this year or that have been called, or to refund bank loans. The largest offering was $50,000,000 first mortgage 4 per cent bonds of the National Steel Corporation, due in 1965 and priced at 100½. Other important offerings included $15,000,000 National Distillers Products Corporation debenture 4½s of 1945 at par, $15,500,000 San Diego Consolidated Gas & Electric Company 4s of 1965 at 101, $13,500,000 Union Oil Company of California serial debentures, $12,000,000 Atlantic Coast Line Railroad collateral trust 5s of 1945 at par, $17,100,000 New York City corporate stock and bonds running six to eleven months at prices to yield 1.00 per cent, and $7,500,000 City of Chicago serial 3½s. An important stock offering was $19,371,800 in 5½ per cent preferred shares of the Commercial Credit Company in exchange for five different classes of preferred stock previously outstanding, for the purpose of simplifying the company's capital structure and reducing preferred dividend charges.

Some of the new bonds sold this Spring carry the lowest coupons that have been used since the late '90s, in the period of depressions which followed the panic of 1893 and accompanied the agitation over the standard of value at that time. In the plethora of accumulating funds at that time, a number of railroad issues with a coupon rate of 3½% were marketed and a few as low as 3%. In the subsequent course of business revival, money came into demand, rates strengthened and these low rate issues suffered market declines.

Much was said at that time to the effect that owing to the growth of wealth interest rates probably had suffered a permanent decline, and similar talk is heard now. Events have proven that the low rates of that period were caused by the slackening of enterprise and loss of confidence resulting from the political agitation. Interest rates are deter-

mined by demand and supply and the oft-repeated theory that industrial development has come to an end has been refuted over and over again. The demand for capital at present is held in check by all of the uncertainties in business.

The situation also refutes all the representations that capital has not suffered from the depression, because interest rates on time contracts remained unaltered. It is true that a period of industrial disorder and depression works injury to many persons who have entered upon contracts of various kinds. This is to be regretted, and is something to be thought of in entering upon War, but contracts are entered upon for the purpose of assuring certain mutual gains, and the right to make them was insisted upon by our liberty-loving forefathers. Contracts must be dealt with as the parties may agree or the laws provide, but it is evident that unemployment affects the income of capital in the same manner that it does the income of labor.

It is pertinent to say that high premiums on 4 per cent capital mean danger to investors, for when the situation changes and the dammed up capital flows into construction and industry the buyers of these high-priced securities will find the market value of their investments declining and the income value depreciating by comparison with rising costs of living.

Government Financing

An innovation in United States Government finance was introduced by the Treasury's announcement of an offering of $100,000,000 in 3 per cent bonds of 1946-1948 to be issued June 3 to the highest bidders instead of offering the issue at a fixed price. Although a block of Panama Canal bonds was sold on this basis in 1911, the method had not been used in recent years until 1929 when a plan was adopted for selling short term, non-interest bearing Treasury bills at a discount to competitive bidders. Some of the Federal Farm Mortgage bonds and Home Owners Loan bonds have also been sold under competitive bidding.

It is said that if this test offering of long term Treasury bonds proves advantageous it may become an important feature in the Government borrowing that will be necessary to finance the $4,000,000,000 public works program. A loan of several hundred million dollars is expected on June 15.

The Proposed Banking Act of 1935

On May 20, 1935, Mr. James H. Perkins, Chairman of the Board of this Bank, and member of the Federal Advisory Council from the New York Federal Reserve District, appeared by invitation before the Subcommittee of the United States Committee on Banking and Currency to give his views on the pending banking bill under consideration by that Committee. It is believed that the statement made by Mr. Perkins on that occasion will be of interest to our readers. The statement follows:

Mr. Chairman:

I approve the enactment of Title I and Title III of the proposed banking bill. Such slight modifications as are suggested in the report of the Federal Advisory Council are technical in character and in no way affect the purposes of these two sections which greatly improve and simplify the present law.

I have never been a believer in deposit insurance, but I have felt that at least one good might result if it could be made the instrument for unifying the banking system. For this reason I wish particularly to endorse the provision requiring all members of the Federal Deposit Insurance Corporation to become members of the Federal Reserve System by 1937. I believe our dual system of national and state banking, operating under forty-nine different controls, is one of the worst features of our banking structure, and I do not think that we shall ever have an effective supervision of banking until this dual system is unified. In setting up the deposit insurance law, Congress very wisely recognized that banks participating in insurance protection ought to conform to uniform standards of soundness and liquidity. The provision requiring all insured banks to join the Reserve System has had the double good effect of both strengthening the basis of the insurance fund and of paving the way for the unification of banking control so badly needed.

Now, however, the lower House of Congress has seen fit to delete from the bill the provision requiring insured banks to be members of the Federal Reserve System. I believe this is a serious mistake, and I wish to add my voice to that of Governor Eccles and others in urging that this provision be retained, with such modification as may be deemed desirable in order to aid banks in qualifying for membership.

I am also assuming that the assessment provisions of the Senate Bill as introduced will be retained, authorizing the Board of Directors of the Federal Deposit Insurance Corporation to fix the rate of assessment at any figure up to a maximum of one-twelfth of one per cent of total deposits per annum.

There has been much discussion as to the wisdom of including Title II in the banking bill this year, or withdrawing it and referring the questions dealt with to a Commission for further study.

The vital points of Title II are the power to fix the discount rate, the power to fix the percentage of reserves which the member banks must carry with the Reserve Banks, the power over open market operations, the broadening

of eligibility requirements for paper submitted both for rediscount and for use as backing for note issues, and the liberalization of the law relative to loans on real estate.

Under the present law, the Federal Reserve Board assumes the power to fix the discount rate. Under the present law (Section 18 of the Federal Reserve Act) the Federal Reserve Board, with the approval of the President, has the power to change reserve percentages. Under the present law (page 157 of Federal Reserve Act), at the request of the President, the Federal Reserve Board and the Secretary of the Treasury have wide power to control the open market operation of the Federal Reserve banks within very liberal limits. Section 10b of the law which expired in March of this year, if re-enacted for a period of time, would cover satisfactorily the question of the broadening of rediscount privileges. The only important new subject dealt with is the extension of the power to loan on real estate. Aside, however, from the assumed power to fix rediscount rates, all of these powers were granted under emergency conditions. While doubtless justified as the emergency measures, they are not in my opinion suitable as permanent legislation either in their present form or as contemplated in this bill.

Moreover, three major subjects which are not covered in the bill are the definite unification of the banking system, branch banking, and the problem of the classification and investment of time and demand deposits.

I know of no present or probable emergency that cannot be met by the law as it now stands (with the re-enactment of Section 10b).

Therefore, unless Title II is altered to include the changes suggested by the Federal Advisory Council, I feel forced to express my objections to it, and to urge postponement of this Title until the best qualified minds of the country can explore the whole subject of our banking system, in the hope that a law may be enacted that will stand the test for at least a quarter of a century.

I want to call attention not only to the powers that a central monetary board has but also to its responsibilities, and to raise a doubt as to the wisdom with which these are likely to be met. The history of the control of central banks by Governments both abroad and in this country hardly justifies a belief in an all-wise exercise of such powers. There is no doubt but that the unsound monetary policies of Germany, which contributed so much to the collapse of the German Mark, were facilitated by the Government control of the Reichsbank. Both in Germany and in France the power of the Government to force continuous advances from the central bank was a leading factor in the depreciation of the currency. In our own recent experience with inflation between 1926-1929, I am impressed with the fact that there were instances where the directors of the regional Reserve Banks proved wiser in their analysis of the situation than the majority of the Federal Reserve Board. In 1927 the Federal Reserve Bank of Chicago opposed the cheap money policies of the Board, which many believe laid the basis for the 1928-1929 boom, and was overruled by the Board. In the Spring of 1929 the Federal Reserve Bank of New York voted again and again to raise the rediscount rate in order to check the wild speculation in the stock market, and the Board again and again refused these requests for fear of hurting business. I do not mention these instances of failure to foresee coming events with any derogatory intent. I simply refer to them as illustrating the fallibility of human judgment even where there is the sincerest intention to act in the best interests of the country. In short, I have a great skepticism that this idea of the centralization of control and responsibility will work as well in practice as it sounds in theory.

If, however, Congress does not wish to defer action on this bill, I want to point out that Title II fundamentally changes our banking system. It places in the hands of a Board the power to dictate arbitrarily the money policies of the country (Section 205). Although I assume that the purpose of the bill is to provide a system of money control, it makes possible the financing of the Government up to many billions of dollars simply on the decision of a small Board working in conjunction with the Treasury (Section 205, Section 208). The latter power would permit an expansion of the currency of the country by about seven and a half billion dollars, more than double the present amount, without the approval or instruction of Congress.

The present Federal Reserve Law gave to the country, for the first time, a system whereby the supply of credit and currency expanded and contracted automatically with the needs of commerce, industry and agriculture. In recent years, we have had a tendency toward managed control of credit. If for the automatic control provided by the original Federal Reserve Act there is to be substituted the conscious control of a Board, the membership of that Board must be as far removed as possible from the influence of any group, be it financial, industrial or political, and should be representative not only of the Government through the members of the Federal Reserve Board but of the Federal Reserve Banks which are in intimate daily contact with conditions in the country. For this reason, I have approved the following recommendations of the Federal Advisory Council:

1. **That the Secretary of the Treasury and the Comptroller of the Currency cease to be members of the Federal Reserve Board.**
2. **That the Board be reduced to five members.**

3. That the governor and members be appointed for fifteen years, and be removable only for cause and after appropriate notice and hearing, but compelled to retire at the age of seventy with adequate pensions.
4. That the Federal Reserve Bank governors be appointed by the directors of the Federal Reserve banks with the approval of the Federal Reserve Board, but that after the approval of the Federal Reserve Board has once been obtained, the governors may be re-elected annually by the directors of the banks.
5. That a committee composed of the members of the Federal Reserve Board and four of the bank governors, selected by the twelve governors, shall be given the power to fix the discount rate, the percentage of reserves, and direct the open market policies of the banks.

I further believe that even if the greatest success should be attained in the selection of the group exercising these powers, common prudence dictates that there should be LIMITS within which they should operate. I accordingly approve the following recommendations of the Federal Advisory Council:

1. That the Open Market Committee should not have the power to increase the percentage of reserves required of member banks to more than 30% of total deposits.
2. That there be a top limit set on the potential open market powers. This, at the same time, provides a safeguard in that it limits the extent to which the Federal Reserve System can be forced to finance governmental deficits. The Federal Advisory Council has recommended that this be handled by limiting to one billion dollars the amount of Government securities which can be used as collateral for Federal Reserve notes.

These limits are broad enough to control the situation in normal times, and, in fact to meet any emergency likely to become acute before Congress could convene. The desirability of limits is increased if their incorporation in the statute would eliminate any constitutional question as to there being an illegal delegation of legislative power.

It would not be proper to omit from a statement on the bill any comment on that part of it which broadens the discount privileges. I believe a broadening of this privilege to be a good thing, but that as in other of the great central banks, any paper which is not self-liquidating within a reasonable time should pay a penalty rate. In this way there would be a more automatic adjustment of the supply of money to strictly business requirements, and the goodness of discounted paper would be tested by frequent maturities. For this reason I approve the recommendations of the Federal Advisory Council for the reenactment of Section 10B of the Federal Reserve Act with slight changes in phraseology, in the place of the provision of the pending bill that all sound assets be rediscountable without discrimination as to their liquidity.

In concluding, I want to emphasize again the two points which, to my mind, are vital in connection with this bill, namely, the necessity for safeguarding the independence of the Board exercising these powers, and the need for limits within which it must operate.

I have refrained from discussing my recommendations in greater detail because they are incorporated in the statement of the Federal Advisory Council.

Further Comment upon the Bill

The foregoing statement by Mr. Perkins describes in general terms the features of the measure that are subjects of disagreement. The comments following are intended to be more explicit as to certain features.

The bill is known as the Eccles bill, inasmuch as Mr. Marriner S. Eccles, present Governor of the Federal Reserve Board, has been its chief expositor. Governor Eccles argues that the changes proposed "are not revolutionary, do not alter the fundamental character of the Reserve system" or "increase the powers of a political administration over the Reserve Board," but rather that they are consistent with the original purposes of the Reserve Act and carry them to a logical conclusion. On the other hand, Dr. H. P. Willis, Professor of Banking in Columbia University, and who served as expert adviser to the Banking and Currency Committee of the House when the Federal Reserve Act was framed by that body in 1913—and on account of his familiarity with the Act was elected the first Secretary of the Federal Reserve Board—in a detailed review of the bill, in the "Financial and Commercial Chronicle" May 18, 1935, sums up by saying that "there is no respect whatever in which the content of the Eccles bill can be regarded as in any sense completing the Reserve Act or carrying it to its natural and logical conclusion," and that "on the contrary, the adoption of the Eccles bill would be a radical defeat of the major underlying principles upon which the Reserve legislation was founded." Furthermore, Senator Glass, of Virginia, who as a member of the House in 1913, and Chairman of the Committee on Banking and Currency, introduced the bill for the Reserve Act and piloted it through that body, has expressed his opinion in similar terms, taking occasion to pay a hearty tribute to Dr. Willis for his part in the preparation of the Reserve Act and to his competency for discussing the subject. It is in order also to mention that more than sixty professors of economics and banking in the higher institutions of learning of this country, cooperating as the "Economists' National Committee on Monetary Policy," have signed a memorial to Congress, making objections to the bill similar to those offered by Senator Glass and Dr. Willis. These statements show that the opposition is not confined to bankers and that it has a basis in recognized economic principles.

The Authority of the President

The declared purpose of the bill is to enlarge "public control" over banking, which it seeks to do by enlarging the authority of the

President over the Reserve Board, the authority of the Reserve Board over the Reserve banks, and finally the authority of Reserve banks over the member banks in their relations with the public. The members of the Reserve Board already are appointed by the President, but for a definite term of ten years. This bill provides that of the six appointed members two shall be designated as Governor and Vice Governor, as at present, but with the new provision that the Governor shall serve as such *until the further order of the President,* and, furthermore, that the ten-year term of office *shall not apply to the Governor.* This would make that official's term of office completely subject to the will of the President, and the Vice Governor would be subject to the same influence. The House has amended the bill in this respect, providing that the Governor, if displaced as such, may serve out his term as an ordinary member; and this action amounts to recognition that the new authority proposed for the President would give him a power of duress over at least two members of the Board. Obviously the provision is improper and the objection to it is not overcome by the House amendment.

No such condition attaches to appointments to the Interstate Commerce Commission or the Federal Trade Commission, and it has happened that while this bill is pending the Supreme Court has decided that the removal of the late W. E. Humphrey from membership of the latter body was unconstitutional because "the Commission was enacted by Congress as an administrative body exercising quasi-legislative and quasi-judicial duties" and as such "must be free from Executive control." "Holders of partly judicial duties can be removed during terms of office only on the grounds stated in the laws creating the agency."

Governor Eccles responds to the objection that the bill would increase the authority of the President in the Reserve system by saying that practically it would not do so, because the President already appoints the Reserve Board and no one possessing proper qualifications for membership would want to remain a member if he knew that the President desired to appoint another person to his place. This is only saying that in the opinion of Governor Eccles the President should dominate the Board, without making any reply to the objections to that policy.

As opposed to this view, Dr. Adolph C. Miller, who resigned from the faculty of the University of California to accept appointment as a member of the first Federal Reserve Board, and has remained a member to this day, responding to an inquiry before the Senate Committee as to the advisability of giving the Board authority over bank credit, said:

> Authority should not be conferred on the board for that purpose unless you are prepared to give the board a status of complete independence—one that is completely independent of any improper influence or legally suggested influence on the part of banks or the Government.

The Secretary of the Treasury, Mr. Morgenthau, appearing before the Committee, expressed the opinion that members of the Reserve Board should have a position of complete independence, removable only by impeachment. This implies a body that in its special field would hold a position in the esteem of the public corresponding to that held by the Supreme Court of the United States. Nobody would suggest that the Chief Justice of this Court should hold office subject to the will of the President.

This idea of the independence of the Reserve Board is expressed by Mr. Perkins in his statement to the Committee, subject, however, to his reference to the "automatic control" which governs every part of the economic system when the system is left to itself. There is no recognition of automatic or natural control in any of the arguments for this bill.

The Problem of Governmental Control

The problem of "public control" over banking, currency and credit is just a part of the larger problem of "public control" over all economic relations, and many of the pronounced advocates of the former evidently are interested in it, as a means of advancing more comprehensive plans. Many good people theorize upon the gains that might be achieved by a system of control that would smooth out all present irregularities and eliminate mistakes, wastes and lost motion, so that everybody would have nothing to do but enjoy himself. The universe, however, has not been planned on that principle. Mankind began in great simplicity and has just "developed" by virtue of its efforts. This seems to have been the "plan." It is desirable that all irregularities shall be smoothed out, but a democracy must do that for itself.

In every undertaking for public control or management the problem is, first to find the individuals who have the qualifications for the task, and then persuade the "public" to select them for it and keep them at it. The public itself is an uncertain, emotional, quantity, never twice the same. The Supreme Court of the United States is as reliable as any human institution, but it is always changing: new members are selected by the President, and the President is elected by the people. Moreover, the 5 to 4 decisions are a little disturbing, although even in these we have the assurance that something at last is "settled" and business may go on.

The ideal for a Federal Reserve Board would be one as certainly independent, intelligent and trustworthy as the Supreme Court of the

United States, and yet it is rationally certain that the processes of any human court or commission are a mere makeshift in comparison with the workings of economic law. The "automatic control" of the latter is always preferable, if it can be allowed to have its way.

The Federal Reserve System

Dr. Willis, in the article referred to, states a fact already known, viz: that the authors of the original Reserve bill did not plan that a government board should be the directing and responsible authority of the Reserve system. They were too familiar with the history of Government adventures in banking and currency issues for that. They knew the danger of politics in it. They knew that every financial crisis and business depression this country ever has known had been aggravated by political and partisan controversies over money and banking, and that these are the most inflammable and explosive of all subjects when involved in politics.

The intention, as Dr. Willis explicitly states, was to "place the management of banking in the hands of bankers and to provide that the Government should have the opportunity to be present at all deliberations, to be fully informed upon what was going on and express opinions and have an adequate voice in reaching conclusions." Of course, it was to have the responsibility of enforcing the law.

The plan was for an overhead structure based upon the existing national and state banking systems, which would serve to integrate and unify all banking facilities and give the country a stronger, more coherent and more serviceable banking organization than it ever had had before. The authors did not want to disturb the existing banks, but to provide a plan by which they could cooperate more effectually. They wanted to serve industry and trade—the regular business of the country—and to restrict banking to that task. They did not want to give large powers in the active management of banking to a government board. They had to compromise in the matter of a full government board at Washington, but they circumscribed its powers to conform to their general idea of how the banking business should be conducted, as follows: (1) that, subject to basic banking principles, the member banks should be responsive to the wants of the people doing business with them, who, it may be noted, are doing all of the other business of the country and supplying the deposits that are the basis of the whole system; (2) that the Reserve banks should be responsive to the member banks, who supply their capital; and that the Federal Reserve Board, overhead, two removes from the public, should perform the functions of a coordinator and supervisor, exercising a degree of authority to the end that the twelve Reserve institutions, covering an area nearly equal to that of all Europe, should operate harmoniously, cooperatively, and in compliance with the Reserve Act. They believed that a banking system thus conducted would automatically maintain its equilibrium and render the greatest possible service to production and trade, and thus to all the people.

This plan was a compromise between those who wanted less Government in the management and those who wanted more, but it satisfied the former because it left the management of banking as close as it could be to the people.

Automatic Regulation of the Economic System

The principle of automatic regulation of the economic system is implicit in the fact that fundamentally all business consists of an interchange of services. Very early it was discovered that a man acquired skill by applying himself to one kind of work, and that community production would be increased by specialization and interchange. The very oldest writings of the Bible tell of the hand trades about as we have them now, and all modern industry and science has developed upon the same principle. The difference in the standard of living between China and the United States has resulted from higher specialization in this country, with the use of capital in the form of specialized machinery. We are all specialists, each buying what he can of the products of others by selling his own. It is a refined system of barter, carried on by the use of money, which is only a means of measuring and comparing values, and accomplishing the exchanges. The only real values in the market are the goods and services moving in trade. These actually buy and pay for each other, but because everybody sells and buys for money many people who ought to know better have come to think of money as an original source of value, and enormously exaggerate the part it plays in the fluctuations of business.

We have several times quoted the apt aphorism by Professor F. W. Taussig, of Harvard: "The fundamental fact of exchange is thus obscured by the very mechanism which so perfectly facilitates it."

Of far more importance than fluctuations in the volume of money are the disturbances that occur in the relations between the different groups of the economic system. They sell to each other, and depend upon each other's purchasing power, and since general purchasing power is the secret of prosperity, all groups tend to be prosperous or depressed together. Prosperity is a state of balanced relations, enabling all kinds of products and services to be readily exchanged and move into consumption, with everybody employed and enjoying the highest standard of living possible at the

existing capacity for production. This is the "economic equilibrium" that economists talk about. Of course it never is perfect, because the system itself, in its organization and equipment, is always undergoing changes which in some degree are disturbing. However, such changes on the whole are constructive and beneficial, because they increase the capacity of the system to supply more fully the wants of the people. So long as the different parts remain in balance they can increase their trade indefinitely. The derangements are insignificant and do not occasion permanent unemployment or any general depression.

Under such conditions natural economic forces tend to keep the system in balance. The law of supply and demand is always in action and under it if any occupation is overcrowded the compensation will decline and thus direct activity elsewhere. Millions of workers are dropping out annually and millions of new workers are making choice of where to join the system. Moreover, there is freedom to shift from one occupation to another, and more or less of this is always going on. Ordinarily only slight shifts are necessary to restore the balance and the system is self-regulating by the free choice of its members.

Every financial crisis or business depression known to history has been caused by extraordinary influences, originating outside of the normal activities of production and exchange, and usually from acts of political governments, or failure on their part to perform their proper functions. Wars have caused the greatest disturbances, and of course the World War caused the most universal and violent disturbance of economic life that ever had been known.

Causes of the Depression

The argument by Governor Eccles dwells upon the disorders arising from the extraordinary use of bank credit prior to 1929, and the ills resulting from the banking crisis, without, in our opinion, giving proper recognition to the primary cause, and this results in an overemphasis upon the responsibility of banking. Indeed he discredits the idea that the war had anything to do with the inflation and subsequent deflation of credit and prices. In his statement to the House Committee he says:

> Our present financial troubles are not due to the war. We had replaced all our losses, including men-power, by 1929. We did not impoverish ourselves in the war, because we used much less than we produced. The surplus we sold to the Allies, as evidenced by the war debts.

This is all. Is it an adequate appraisal of the effects of the war and its consequences upon the United States? Nothing is said of the losses resulting from derangements in production and trade. His attention is respectfully directed to the writings of the Secretary of Agriculture upon the effects of the war to this date upon American farmers, and to abundant evidence of its effects upon the producers of other primary products, and upon the world-wide relationship between primary products and manufactures and transportation. The effects of the war have been cumulative, one result following upon another. What has been the cost of the withdrawal of Russia from the community of nations, of the new barriers to trade resulting from the establishment of six new nations in Europe, of the disruption of trade relations with Germany, the breakdown of the international standard of value, the confusion of monetary systems, including our own devaluation, the frantic efforts of governments to suppress all exports but their own, and other derangements affecting trade, both external and internal?

During the pressure of war-time demands, wages and prices of all kinds rose fairly well together, so that the basis of the exchanges was not seriously disturbed, and during the post-war boom, which was largely based upon postponed demands, price relations changed but slightly from 1922 to 1929, but in the period 1929-32 average prices of farm staples declined to less than one-half their average in the five years ended with 1913, while average wages in manufacturing and transportation remained approximately 100 per cent above the pre-war level. Is there anything in the economic principle that an approximate state of balanced relations is necessary to normal prosperity?

Did the war and the doubling of this country's banking reserves have anything to do with the rise of prices, the speculative "orgy," and the increase of private, as well as public indebtedness? We give below a table showing the outstanding farm mortgage indebtedness of the county in which the Iowa State College of Agriculture is located, at the beginning of each decade from 1880 to 1920, as compiled by the College:

Outstanding Farm Mortgage Debt in Story County, Iowa, at Ten-Year Intervals, 1880 - 1920

Year as of Dec. 31	Acreage Under Mortgage (*)	Debt Per Acre	Percent of Farm Land Mortgaged	Aggregate Debt
1880	161,929	7.72	45.7	1,250,774
1890	180,513	10.71	50.9	1,934,180
1900	163,718	18.55	46.2	3,037,067
1910	161,052	36.75	45.4	5,915,553
1920	206,461	111.24	58.3	22,966,616

(*) All farm land in county, in 1930, 354,434 acres.

What is the significance of the rise of this indebtedness from 1910 to 1920? Did the war have anything to do with it? Did the New York bankers have anything to do with it? Did the increase of farm indebtedness in Iowa and elsewhere, and subsequent fall of farm staples to one-half the pre-war prices, have any reaction upon general business in this country?

Quotations from Governor Eccles

A few quotations from Governor Eccles will show the theories that have shaped the bill. We quote:

> The need for public control of the function of supplying the medium of exchange to the people of the United States, both by issuing currency and by regulating the volume of bank deposits, seems to be almost a non-controversial matter. It is in direct recognition of the constitutional requirement that Congress shall coin money and regulate the value thereof. * * *
>
> Recognition of the fact that control over money is a matter of national concern that must be retained by the sovereign power or delegated by it to an agency of its own creation is as old as Government itself. The change that has occurred in the past quarter of a century has been in the nature of adaptation of an ancient idea to modern conditions. The change has arisen out of a growing recognition of the fact that monetary control must not be confined to control of currency because, to an ever increasing extent, the bank check has taken the place of currency. In this country fully nine-tenths of all payments are made by check rather than in cash. Control over the supply of money, therefore, involves under existing conditions a control over the volume of bank deposits and bank credit. * * *
>
> The necessity of Government control arises from the fact that governments are largely instruments for the formulation and execution of economic and financial policies. * * *
>
> During the depression the supply of money did not expand and thus moderate the effect of decreased rates of spending, but contracted rapidly and so intensified the depression. This is one part of the economy in which automatic adjustments tend to have an intensifying rather than a moderating effect. If the monetary mechanism is to be used as an instrument for the promotion of business stability, conscious control and management are essential.

The following is from a report of his statement before the House Committee:

> Mr. Eccles said the depression resulted from an inequitable distribution of wealth produced. ** It was evident that those in the one-tenth of 1 per cent bracket could not possibly expend their income on consumer's goods, he continued. Thus an increasing flow of savings was put into producers' goods, until the productive plant of the country far outran the nation's ability to consume, although its capacity to consume was still as great as before.

First as to money: It is an error to say that governments always have maintained control over money or instruments of exchange. The coinage of standard money always has been unrestricted, on private account, and simply a certification of the contents of the coins.

In this country, the Constitutional authority of Congress to "coin money and regulate the value thereof" obviously refers to coins and not to paper money or bank deposits. All countries at that time used both gold and silver as standard money and it was necessary to regulate the weight of the two sets of coins to each other. This is a rational interpretation of the language. There is no reason for believing that the makers of the Constitution were intending to give the Congress authority over bank notes, bank deposits, bank loans or the purchasing power of money over commodities. On the contrary there is every reason for thinking the contrary. Thomas Jefferson was the great champion of democracy and opposed to the centralization of power in the federal government. In the controversy with Hamilton over the Bank of the United States he held that Congress possessed no power to charter a bank, or any power not specifically granted by the Constitution, which would exclude the power to issue currency of its own or to regulate the business of banks chartered by the States. It is unreasonable to suppose that he ever contemplated giving Congress an authority to change at will the purchasing power of money.

The Nature of Bank Deposits

No court ever has held, even by implication, that bank deposits or bank checks were money. Bank checks are instructions to pay money on private account. Would a letter of like effect be money or an infringement upon the Constitution? Business is always looking for the most economical ways of doing things. The fact that all business consists of exchanging services has made it possible for a banking system to effect economies in the cost of using money for all payments. The cotton produced in the Southern States is shipped out to market and creates bank deposits in central markets in favor of those States, against which the South draws checks in payment for the products of other parts of this country and foreign countries. In like manner, States producing wheat, corn, livestock, lumber, coal, iron, automobiles and other products accumulate bank credits in central cities and check against them. All of these checks, passing through the 430 clearing houses in a continuous stream, almost cancel out, *because the products which they represent are being exchanged.* The checks arise from the purchases that the sections are making of each other, and the payments are being made in the most expeditious manner. Moreover, Governor Eccles says that more than 90 per cent of the payments of the country are being made in this manner.

Then why all this bother about money—the other 10 per cent? Is not this bank deposit currency directly related to the volume of business, and what better test of a currency supply can be had? It is the most convenient, responsive and economical currency that ever has been devised, for each issue is for a specific purpose, after which it is cancelled and retired. Why should the Government seek to control these private deposits? If it is because the volume of bank deposits and purchasing power partially results from loans, the place for control is over loans, not over deposits, which is precisely the difference between the Reserve Act and this bill.

Before leaving this description of the clearing process by which the great bulk of the country's payments are handled, it is pertinent to invite attention to the effect of unbalanced trade relations upon bank clearings. When the prices of farm products fell to more than

50 per cent below the pre-war level, while the costs of transportation, taxes and urban services generally remained above the pre-war level, the clearings declined rapidly. The farmers could buy only to the extent that their products supplied purchasing power. The total payments through the reporting banks of the Federal Reserve System fell from $925,000,000,000 in 1929 to $332,000,000,000 in 1932. The reference to the farmers is only illustrative; the decline in the clearings resulted from all maladjustments in trade relations, but the report is incomplete, not including all banks. However, it affords some idea of the loss of business in one year resulting from the loss of equilibrium in the economic system, caused primarily by the war.

Matters in Disagreement

The differences between Governor Eccles and the opponents of the bill are mainly over his theories of money and banking power. He attributes to money and banking certain conditions which bankers affirm had their origin in the war, viz.: primarily, the inflation of credit and prices and the speculation and debt-making incidental thereto; secondarily, the irregular decline of prices and consequent disruption of price relations, which checked the flow of products into consumption. Of course, prices fell farther as surpluses piled up, as unemployment increased and as consumption continued to decline. Bankers deny their responsibility for this.

In the opinion of bankers and most teachers of economics, he overemphasizes the control over business conditions that can be exercised through money: which is the basis of his argument that the Government should control money and all substitutes that serve as purchasing power. The opposing view is that instruments of exchange are facilities of business which are used as business wants them, and that the initiative is with business and not with bankers or the Government. The public buys freely and borrows for the purpose when it sees opportunities for profit; on the other hand, it sells freely, pays off debts and hoards purchasing power if it loses confidence in the outlook and suspects that prices are going lower. Issues of paper money by the Government, or of credit by the Reserve Banks, can accomplish nothing unless the public has the will to use purchasing power. A plethora of currency and of lending power has existed ever since 1929. Forced additions to the money supply by the Government can not help such a situation, for two reasons, viz.: they can not correct the maladjustments in production and prices, and they become of themselves a new element of uncertainty and alarm.

The argument offered by Governor Eccles, carried to its logical conclusion, would require that the Government itself should take the place of private business in the employment of purchasing power.

Methods of Control

There is no disagreement among bankers over the general proposition that in order to prevent crises and depressions it is necessary to prevent abnormal booms and their rising prices, with the accompanying speculation and increase of indebtedness. To this end a policy of restraint should be imposed when the unwholesome expansion is getting under way; but the wartime inflation of credit and prices was caused by the war, and the post-war period of inflation and speculation was financed in part by the credit released from war-financing and by further gold importations, resulting from disturbed conditions in Europe.

These conditions have been extraordinary; they were not caused by our banking system and could not be; all countries have suffered likewise. To enable the authorities to cope with them, certain emergency acts have been passed. It will be well to have them continued as emergency provisions, but the powers of control should not be enlarged in such manner, except for use in the event of a repetition of like conditions. The fact should be emphasized that the normal operations of production, trade and banking tend naturally to maintain the "economic equilibrium." Such regulation of the volume of bank credit as may be required should be applied through the regulation of bank loans and investments, with the aim of keeping the banks in sound and liquid condition. This the framers of the Reserve Act sought to do by the provisions restricting the class of paper acceptable at the Reserve Banks. The Eccles bill dispenses with these restrictions, leaving eligibility wholly to the management. This is objectionable.

As to the "Inequitable Distribution of Production"

The references to the need for central control over banking in order to promote the economic policies of the Government, and the opinion that the depression was caused by inequality of incomes, invite more extended comment than can be given here. They plainly indicate a purpose to use banking resources for purposes outside the banking field and to forward policies over which there are marked differences of opinion. The resources of the system are privately owned, and should not be used by public authority to advance debatable social policies. It may be added as pointing this objection that the opinion regarding the inequitable distribution of current production is not supported by authentic evidence.* Governor Eccles may have been misled by certain figures given out by the Research and Plan-

* See "Statistics of Income," U. S. Treasury Dept., and "National Income, 1929-32" Senate Document No. 124, 73d Congress 2d Session.

ning division of the N.R.A., which were soon after retracted. The investments in industrial plants during this period were largely for the purpose of reducing costs, and were inevitably stimulated by the increase of wage rates and prices after 1914, which prompted competitive efforts to lower both costs and prices. Prices were declining during the period, and in no year from 1922 to 1929 inclusive did the average net income of all corporations in the United States amount to 5 per cent of the value at which the products and services were sold. In no other like period of record was the margin of net income so low.

The Specific Proposals

The provisions of this measure may be summarized as follows: An enlargement of general control by the Government over the banking business, extending to the approval or veto of the choice of the Reserve Bank directors for their chief executive; to control over the open market operations, which means the investment of reserve deposits in Government bonds, etc.; and finally a change in the eligibility requirements of the Reserve Banks which would affect the character of member bank loans and investments. Upon the theory that the eligibility conditions prescribed by the Reserve Act have become impracticable because of "new conditions," the bill would take down the bars for everything, including real estate mortgages on a greatly increased scale. We have not the space to permit a proper discussion here of paper suitable for Reserve Bank or member bank investments, but do not hesitate to say that this new proposal owes too much to the influence of the extraordinary conditions created by the war.

Always in the past there have been two distinctive, though related, money markets, one for long-term financing and the other for short financing. There are borrowers and lenders who are best served by one market or the other, and the natural play of supply and demand in the two markets would determine interest rates in both and cause more or less shifting of funds from one market to the other. The phenomenal borrowings of the wartime and years following affected the situation to some extent, particularly in the tight money period of 1919-20. It prompted corporations that were accustomed to rely upon issues of commercial paper to finance themselves by increasing their capital stock or issuing bonds or long-term notes. It was a policy of precaution, resorted to in increasing degree as conditions became more stringent and unsettled.

There is an economy in adjusting capital charges to the volume of business, and bank loans enable this to be done, but stable conditions are required to encourage it. It is reasonable to believe that with a return to normal conditions the employment of bank credit will revive. It is largely a matter of confidence in a reliable supply of short money. It is a hasty assumption that there will not be a demand for it. The reasons against loaning bank deposits, payable on demand or short notice, upon unliquid assets are as good now as ever they were. There is no need to adapt the rules of banking to suit abnormal and unsound conditions. These proposals explain the attitude of Senator Glass and of Dr. Willis referred to above.

In Conclusion

The plan as a whole would take banking control and direction farther from the people who supply the banking capital of the country, the people who supply the bank deposits and the business public that uses the facilities of the system, and place it with an authority too far removed to capably use it. Also, by all the experience of the past it lowers the standard of bank investments. Moreover, the proposal is based in part at least upon the theory or assumption that the interests of bankers are in conflict with the interests of the public, which has no basis whatever in truth. The banking business is based mainly upon the deposits — the chief function of bank capital being as protection to depositors against unusual losses. Deposits naturally grow with the prosperity of patrons and the community, and inevitably decline when adversity affects them. Competition assures fair treatment in the banking business as it does elsewhere, and we rely upon it, and upon intelligent self interest as well as integrity, in all of the services that we obtain from each other. We are protected in our free society by the fact that if one specialist fails to give us satisfaction we can find another who will. Anything in the nature of concerted action by bankers against the interests of the public is too preposterous for comment.

Governor Eccles quotes President Wilson as saying early in 1913, when banking legislation was in prospect, that the public policy should be such "that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative." The bankers of the country maintain that this quotation describes precisely the position they occupy, that their own interests require them to occupy it, and that they are controlled by the same "automatic regulation" that inspires every honorable business man to serve and satisfy his patrons.

If the Governments of the world will perform their part in providing for social stability and progress, by abstaining from war with each other, and by maintaining order and justice in their own immediate fields of responsibility, then banking and business will be able to perform their part with much greater success.

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